



American Insurance Association

1130 Connecticut Ave. NW

Suite 1000

Washington, DC 20036

202-828-7100

Fax 202-293-1219

www.aiadc.org

December 8, 2006

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856
Via E-mail: derivatives@fasb.org



LETTER OF COMMENT NO. 9

File Reference: *Proposed Issue B40*

Dear Chairman Herz:

The American Insurance Association (AIA) would like to thank the Board for its timely consideration of constituent implementation issues with FASB Statement No. 155: *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140 (FAS 155)*. Although we believe that the proposed Statement 133 Implementation Issue No. B40 *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets (B40)* alleviates our greatest concerns, we do have some issues with FAS 155 that are not covered in B40 and we continue to have a conceptual issue with paragraph 13(b) and related paragraphs of FASB Statement No. 133.

First, we believe conditions **b** and **c** of proposed B40 should allow for insignificant derivatives. Insignificant derivatives (e.g., a clean-up call) would not alter the cash flows significantly and should not expose an investment to be tested under paragraph 13(b) of FAS 133. For instance, if an entity purchases a subordinated tranche of a CMO structure which has a clean-up call, the entity could interpret the clean-up call as violating condition **c** even though the embedded clean-up call would only become effective when the structure is no longer viable and the impact to the cash flows is insignificant. Additionally, the value of the embedded clean-up call would vary mainly due to concentrations of credit risk and/or prepayments in the structure, both of which would preclude testing under paragraph 13(b).

Second, we continue to be concerned with impact of guarantee and servicing fees on securitized interests that fail to meet the scope exception. As stated in our comment letter dated October 12, 2006, "we believe that the intent of the guidance was to capture securities where the allocation among the principal holders is not proportionate and each class may receive significantly more or less than the expected return and return of initial investment. It is our belief that when evaluating the impact of a potential prepayment, we should only look to the distribution of cash flows associated with the embedded call (prepayment) and not the general

cash flows of the structure.” We believe that the FASB should clarify that guarantee and servicing fees do not cause disproportionate allocation.

Our conceptual issue is with paragraph 13(b) and related paragraphs of Statement No. 133. We continue to believe that any accounting test that gives different results for like instruments is inferior and should be addressed. We acknowledge that a whole scale review of the test might take substantial resources and may not meet a cost benefit analysis. As an alternative, we believe that the FASB should consider changing the language from an all scenario concept to a reasonably likely scenario concept in paragraph 13(b) which would be in line with economic reality and would be less likely to identify similar or even the same instrument differently, depending on price and when purchased.

Conclusion

We believe that B40 properly clarifies the implementation issue for most prepayable, securitized interests. We believe that several issues remain for prepayable securitized interests that can be addressed through additional guidance in B40 and a brief amendment to paragraph 13(b) of FAS 133 (and related paragraphs).

Thank you for the opportunity to comment on this issue. If you have any questions regarding our letter please call me at (202) 828-7170.

Sincerely,

/s/ Phillip L. Carson

Phillip L. Carson
Assistant General Counsel
American Insurance Association